

**REPORT OF THE AUDIT OF THE
MAGOFFIN COUNTY
FISCAL COURT**

**For The Fiscal Year Ended
June 30, 2003**



**CRIT LUALLEN
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EXECUTIVE SUMMARY

AUDIT EXAMINATION OF THE MAGOFFIN COUNTY FISCAL COURT

**For The Fiscal Year Ended
June 30, 2003**

The Auditor of Public Accounts was engaged to audit the Magoffin County Fiscal Court for fiscal year ended June 30, 2003. We have disclaimed an opinion on the financial statements. Based on our assessments of fraud risk we have determined the risk for fraud to be high. We were unable to apply other procedures to overcome this fraud risk. The Fiscal Court has serious weaknesses in the design and operation of its internal control procedures. Furthermore, management has elected to override those procedures that were put in place. Because of the significance of these matters, we are unable to express an opinion on the financial statements.

Report Comments

- The County Treasurer Should Prepare Bank Reconciliations For All Bank Accounts
- The County Should Not Incur Bank Overdraft Charges
- The County Treasurer Should Properly Account For All Receipts and Disbursements
- Internal Controls Should Be Implemented To Detect Fraud and Accounting Errors
- The County Treasurer Should Improve Internal Controls Over Blank Checks
- The County Treasurer Should Strengthen Controls Over Access To The Accounting Records
- The County Treasurer Should Strengthen Controls Over Sequence Of Checks Used
- The County Should Improve Their Internal Control Procedures
- The County Should Require All Checks To Have Dual Signatures

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CRIT LUALLEN
AUDITOR OF PUBLIC ACCOUNTS

To the People of Kentucky

Honorable Ernie Fletcher, Governor

Robbie Rudolph, Secretary

Finance and Administration Cabinet

Honorable Bill W. May, Magoffin County Judge/Executive

Members of the Magoffin County Fiscal Court

Independent Auditor's Report

We were engaged to audit the statement of assets, liabilities, and equity arising from cash transactions of Magoffin County, Kentucky, as of June 30, 2003, and the statement of cash receipts, cash disbursements, and changes in cash balances for the year then ended. These financial statements are the responsibility of Magoffin County, Kentucky's management.

During our engagement, we have assessed fraud risk as high. We were unable to apply other procedures to overcome this fraud risk. The Fiscal Court has serious weaknesses in the design and operation of its internal control procedures. Furthermore, management has elected to override those procedures that were put in place. We were unable to satisfy ourselves about the accuracy and completeness of the fourth quarter financial statement by means of other auditing procedures.

Because we were unable to overcome high fraud risk, serious internal control weaknesses, and management's election to override certain control procedures, and we were unable to apply other auditing procedures regarding the internal control system as discussed in the preceding paragraph, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the financial statements referred to in the first paragraph.

In accordance with Government Auditing Standards, we have also issued our report dated February 18, 2004, on our consideration of Magoffin County, Kentucky's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an engagement performed in accordance with Government Auditing Standards and should be read in conjunction with this report in considering the results of our engagement.

The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, Audits of States, Local Governments and Non-Profit Organizations.



To the People of Kentucky
Honorable Ernie Fletcher, Governor
Robbie Rudolph, Secretary
Finance and Administration Cabinet
Honorable Bill W. May, Magoffin County Judge/Executive
Members of the Magoffin County Fiscal Court

Based on the results of our work performed, we present the schedule of findings and questioned costs, included herein, which discusses the following report comments:

- The County Treasurer Should Prepare Bank Reconciliations For All Bank Accounts
- The County Should Not Incur Bank Overdraft Charges
- The County Treasurer Should Properly Account For All Receipts and Disbursements
- Internal Controls Should Be Implemented To Detect Fraud and Accounting Errors
- The County Treasurer Should Improve Internal Controls Over Blank Checks
- The County Treasurer Should Strengthen Controls Over Access To The Accounting Records
- The County Treasurer Should Strengthen Controls Over Sequence Of Checks Used
- The County Should Improve Their Internal Control Procedures
- The County Should Require All Checks To Have Dual Signatures

Respectfully submitted,

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Crit Luallen
Auditor of Public Accounts

Audit fieldwork completed -
February 18, 2004

MAGOFFIN COUNTY OFFICIALS

For The Fiscal Year Ended June 30, 2003

Fiscal Court Members:

Bill W. May	County Judge/Executive
Troy W. Minix	Magistrate
Manuel Minix	Magistrate
Pernell Lemaster	Magistrate

Other Elected Officials:

Donald W. Mcfarland	County Attorney
Gene Helton	Jailer
Haden B. Arnett	County Clerk
Roger Gullet	Circuit Court Clerk
Randall Jordan	Sheriff
Bill Patrick	Property Valuation Administrator
Jerry Dunn	Coroner

Appointed Personnel:

Mary Lea Arnett	County Treasurer
Marcella Salyer	Finance Officer

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STATEMENT OF ASSETS, LIABILITIES,
AND EQUITY ARISING FROM CASH TRANSACTIONS

MAGOFFIN COUNTY
STATEMENT OF ASSETS, LIABILITIES,
AND EQUITY ARISING FROM CASH TRANSACTIONS

June 30, 2003

	<u>Governmental Fund Types</u>		Totals (Memorandum Only)
	<u>General</u>	<u>Special Revenue</u>	
<u>Assets</u>			
Cash	\$ 172,377	\$ 9,914	\$ 182,291
Total Assets	<u>\$ 172,377</u>	<u>\$ 9,914</u>	<u>\$ 182,291</u>
<u>Equity</u>			
Fund Balances:			
Unreserved	\$ 172,377	\$ 9,914	\$ 182,291
Total Equity	<u>\$ 172,377</u>	<u>\$ 9,914</u>	<u>\$ 182,291</u>

The accompanying notes are an integral part of the financial statements.

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STATEMENT OF CASH RECEIPTS,
CASH DISBURSEMENTS, AND CHANGES IN CASH BALANCES

MAGOFFIN COUNTY
STATEMENT OF CASH RECEIPTS,
CASH DISBURSEMENTS, AND CHANGES IN CASH BALANCES

For The Fiscal Year Ended June 30, 2003

	<u>General Fund Types</u>			
	Totals (Memorandum Only)	General Fund	Road and Bridge Fund	Jail Fund
<u>Cash Receipts</u>				
Schedule of Operating Revenue	\$ 5,823,813	\$ 1,705,174	\$ 1,396,332	\$ 58,214
Other Financing Sources:				
Transfers In	987,862	210,785	208,771	221,000
Kentucky Advance Revenue Program	650,000	495,000		
Total Cash Receipts	<u>\$ 7,461,675</u>	<u>\$ 2,410,959</u>	<u>\$ 1,605,103</u>	<u>\$ 279,214</u>
<u>Cash Disbursements</u>				
Comparative Schedule of Final Budget and Budgeted Expenditures	\$ 6,327,749	\$ 1,702,347	\$ 1,272,594	\$ 273,548
Other Financing Uses:				
Transfers Out	987,861	606,587	300,185	
Total Cash Disbursements	<u>\$ 7,315,610</u>	<u>\$ 2,308,934</u>	<u>\$ 1,572,779</u>	<u>\$ 273,548</u>
Excess (Deficiency) of Cash Receipts Over (Under) Cash Disbursements	\$ 146,065	\$ 102,025	\$ 32,324	\$ 5,666
Cash Balance - July 1, 2002	<u>36,226</u>	<u>11,502</u>	<u>5,436</u>	<u>5,170</u>
Cash Balance - June 30, 2003	<u>\$ 182,291</u>	<u>\$ 113,527</u>	<u>\$ 37,760</u>	<u>\$ 10,836</u>

MAGOFFIN COUNTY
 STATEMENT OF CASH RECEIPTS,
 CASH DISBURSEMENTS, AND CHANGES IN CASH BALANCES
 For The Fiscal Year Ended June 30, 2003
 (Continued)

General Fund Types		Special Revenue Fund Types			
Local Government Economic Assistance Fund	Intermodal Surface Transportation Efficiency Act Fund	Community Development Block Grant Fund	Forest Fire Fund	Solid Waste Fund	Sinking Fund Fund
\$ 245,234	\$ 39,737	\$ 1,614,076	\$ 2,915	\$ 666,180	\$
90,000	28,306			190,000	9,000
				155,000	
<u>\$ 335,234</u>	<u>\$ 68,043</u>	<u>\$ 1,614,076</u>	<u>\$ 2,915</u>	<u>\$ 1,011,180</u>	<u>\$ 9,000</u>
\$ 325,664	\$ 71,871	\$ 1,614,073	\$ 6,280	\$ 930,352	\$ 9,475
42				80,490	
<u>\$ 325,706</u>	<u>\$ 71,871</u>	<u>\$ 1,614,073</u>	<u>\$ 6,280</u>	<u>\$ 1,010,842</u>	<u>\$ 9,475</u>
\$ 9,528	\$ (3,828)	\$ 3	\$ (3,365)	\$ 338	\$ (475)
726	3,828		4,020	49	1,101
<u>\$ 10,254</u>	<u>\$ 0</u>	<u>\$ 3</u>	<u>\$ 655</u>	<u>\$ 387</u>	<u>\$ 626</u>

MAGOFFIN COUNTY
 STATEMENT OF CASH RECEIPTS,
 CASH DISBURSEMENTS, AND CHANGES IN CASH BALANCES
 For The Fiscal Year Ended June 30, 2003
 (Continued)

	<u>Special Revenue Fund Types</u>	
<u>Cash Receipts</u>	<u>911 Fund</u>	<u>Reserve Fund</u>
Schedule of Operating Revenue	\$ 95,951	\$
Other Financing Sources:		
Transfers In	30,000	
Kentucky Advance Revenue Program		
Total Cash Receipts	<u>\$ 125,951</u>	<u>\$ 0</u>
<u>Cash Disbursements</u>		
Comparative Schedule of Final Budget and Budgeted Expenditures	\$ 121,545	\$
Other Financing Uses:		
Transfers Out	557	
Total Cash Disbursements	<u>\$ 122,102</u>	<u>\$ 0</u>
Excess (Deficiency) of Cash Receipts Over (Under) Cash Disbursements	\$ 3,849	\$
Cash Balance - July 1, 2002	<u>4,172</u>	<u>222</u>
Cash Balance - June 30, 2003	<u><u>\$ 8,021</u></u>	<u><u>\$ 222</u></u>

REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER
FINANCIAL REPORTING BASED ON WORK PERFORMED



CRIT LUALLEN
AUDITOR OF PUBLIC ACCOUNTS

The Honorable Bill W. May, Magoffin County Judge/Executive
Members of the Magoffin County Fiscal Court

**Report On Compliance And On Internal Control
Over Financial Reporting Based On Work Performed**

We were engaged to audit the financial statements of Magoffin County, Kentucky, as of and for the year ended June 30, 2003, and have issued our report thereon dated February 18, 2004, wherein we disclaimed an opinion on the financial statement based on our inability to overcome high fraud risk and serious internal control weaknesses.

Compliance

As part of our work, we performed tests of Magoffin County, Kentucky's compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not our objective, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance that are required to be reported under Government Auditing Standards and which are described in the accompanying schedule of findings and questioned costs.

- 2003-01 The County Treasurer Should Prepare Bank Reconciliations For All Bank Accounts
- 2003-02 The County Should Not Incur Bank Overdraft Charges
- 2003-03 The County Treasurer Should Properly Account For All Receipts and Disbursements

Internal Control Over Financial Reporting

In planning and performing our work, we considered Magoffin County's internal control over financial reporting in order to determine our procedures for the purpose of expressing our opinion on the financial statement and not to provide assurance on the internal control over financial reporting.



Report On Compliance And On Internal Control
Over Financial Reporting Based On Work Performed
(Continued)

Internal Control Over Financial Reporting (Continued)

However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect Magoffin County's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statement. Reportable conditions are described in the accompanying schedule of findings and questioned costs.

2003-04	Internal Controls Should Be Implemented To Detect Fraud and Accounting Errors
2003-05	The County Treasurer Should Improve Internal Controls Over Blank Checks
2003-06	The County Treasurer Should Strengthen Controls Over Access To The Accounting Records
2003-07	The County Treasurer Should Strengthen Controls Over Sequence Of Checks Used
2003-08	The County Should Improve Their Internal Control Procedures
2003-09	The County Should Require All Checks To Have Dual Signatures

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statement being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we consider all of the reportable conditions described above to be material weaknesses.

This report is intended solely for the information and use of management, federal awarding agencies, and pass-through entities, and is not intended to be, and should not be, used by anyone other than the specified parties.

Respectfully submitted,



Crit Luallen
Auditor of Public Accounts

Audit fieldwork completed -
February 18, 2004

REPORT ON COMPLIANCE WITH REQUIREMENTS
APPLICABLE TO EACH MAJOR PROGRAM AND ON INTERNAL
CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133



CRIT LUALLEN
AUDITOR OF PUBLIC ACCOUNTS

The Honorable Bill W. May, Magoffin County Judge/Executive
Members of the Magoffin County Fiscal Court

Report On Compliance With Requirements
Applicable To Each Major Program And On Internal Control
Over Compliance In Accordance With OMB Circular A-133

Compliance

We have audited the compliance of Magoffin County, Kentucky, with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement that are applicable to each of its major federal programs for the year ended June 30, 2003. Magoffin County's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of Magoffin County's management. Our responsibility is to express an opinion on Magoffin County's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States; and OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Magoffin County's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of Magoffin County's compliance with those requirements.

In our opinion, Magoffin County complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2003.



Report On Compliance With Requirements
Applicable To Each Major Program And On Internal Control
Over Compliance In Accordance With OMB Circular A-133
(Continued)

Internal Control Over Compliance

The management of Magoffin County is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered Magoffin County's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts, and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of management, federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than the specified parties.

Respectfully submitted,

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Crit Luallen
Auditor of Public Accounts

Audit fieldwork completed -
February 18, 2004

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

MAGOFFIN COUNTY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS

For The Fiscal Year Ended June 30, 2003

A. SUMMARY OF AUDIT RESULTS

1. The auditor's report disclaims an opinion on the financial statements of Magoffin County.
2. Six reportable conditions disclosed during the engagement are reported in the Independent Auditor's Report. All of the conditions are reported as material weaknesses.
3. Three instances of noncompliance material to the financial statements of Magoffin County were disclosed during the engagement.
4. No reportable conditions relating to the audit of the major federal awards programs are reported in the Independent Auditor's Report.
5. The auditor's report on compliance for the audit of the major federal awards programs for Magoffin County expresses an unqualified opinion.
6. There are no audit findings relative to the major federal awards programs for Magoffin County reported in Part C of this schedule.
7. The program tested as a major program was: Community Development Block Grant Sewer Project (CFDA#14.228).
8. The threshold for distinguishing Type A and B programs was \$300,000.
9. Magoffin County was not determined to be a low-risk auditee.

B. FINDINGS - FINANCIAL STATEMENTS AUDIT

NONCOMPLIANCES

2003-01 The County Treasurer Should Prepare Bank Reconciliations For All Bank Accounts

Based on our observations, we determined blank checks that were stolen, forged, and later cashed began clearing the bank accounts of the county on May 8, 2002. It was not until the finance officer prepared bank reconciliations for the various bank accounts on July 1, 2002, that the theft of the stolen checks was detected. Had the finance officer prepared bank reconciliations on a monthly basis, the theft of the blank checks would have been detected earlier. We recommend bank reconciliations be prepared on a monthly basis for all the County's bank accounts and the bank reconciliations be prepared or reviewed by someone who does not have access to the accounting records.

County Judge/Executive Bill W. May's Response:

Agree that accounts are to be reconciled timely which is the practice now as has been in the past. However, during the period referred to above, office space was relocated, new office space was set up and all files had to be reorganized. This tremendous amount of work, when added to the everyday tasks associated with the Judge's office and the Treasurer's office, created time constraints on an already short staff. As stated before, all reconciliations are now current and have been for some time. However, the reconciliations have been done by the County Finance Officer in the past, but will in the future be done by the County Treasurer and then reviewed by the Deputy Judge/Executive, who does not have access to the accounting records.

MAGOFFIN COUNTY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
For The Fiscal Year Ended June 30, 2003
(Continued)

NONCOMPLIANCES (Continued)

2003-02 The County Should Not Incur Bank Overdraft Charges

The County had significant bank overdraft charges in fiscal year ended 2002. They have continued overdrawing their accounts and have accumulated \$33,890 of overdraft charges for fiscal year ended June 30, 2003. The majority of these overdrafts occurred in the Payroll Account. The county paid the employees timely, but failed to transfer the proper amount of money to the payroll account to cover the employees' payroll checks. The bank honored the checks and charged the county an overdraft charge of \$25 for each check there were insufficient funds available to cover. The county also had overdrafts in the General Fund, Road Fund, Jail Fund, LGEA Fund, Solid Waste Fund, 911 Fund, Sinking Fund Account, and ISTEAA Account. Furthermore, subsequent to the end of the fiscal year under audit, the county has incurred \$8,124 of overdraft charges. Of this amount, \$4,783 was charged to the Payroll account and \$2,388 to the Sanitation Fund.

We recommend the county establish financial controls to ensure that checks are not drawn on any account where funds are insufficient to cover the checks written.

County Judge/Executive Bill W. May's Response:

Agree that County should not incur overdraft charges. Measures have been put in place to guard against overdrafts and no accounts are overdrawn at this time.

2003-03 The County Treasurer Should Properly Account For All Receipts and Disbursements

The County Treasurer should properly record all transactions in the receipt and disbursement ledgers. During our procedures, we noted receipts and a disbursement totaling \$347,924 had not been properly posted to the ledgers for part of the Community Development Block Grant Sewer Project. Therefore, an adjustment to the ledgers in the amount of \$347,424 would have been necessary to reflect actual disbursements of Community Development Block Grant funds for the fiscal year ended June 30, 2003. We did not make an adjustment to the ledgers because we have issued a disclaimer of opinion. Had the County Treasurer prepared monthly bank reconciliations or posted checks and receipts correctly, these accounting errors would have been discovered in a shorter amount of time. We recommend the County Treasurer properly post all receipts and disbursements to the accounting records.

County Judge/Executive Bill W. May's Response:

Agree that all receipts are to be posted timely.

MAGOFFIN COUNTY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
For The Fiscal Year Ended June 30, 2003
(Continued)

REPORTABLE CONDITIONS AND MATERIAL WEAKNESSES

2003-04 Internal Controls Should Be Implemented To Detect Fraud And Accounting Errors

The County failed to consistently maintain or abandoned internal control procedures that would have discovered fraudulent transactions relating to expenditures. The purpose of internal control procedures is to detect fraud and accounting errors within a relatively short period of time. Management has the responsibility for establishing these procedures. It is important that management consider those internal control procedures they will implement and maintain those procedures to ensure their effectiveness. Management must have the ability to exercise sound judgment, the educational and technical background to recognize and correct problems when they occur, and must not disregard or override internal controls under any circumstances. Through observation and inquiry we determined that certain control procedures were disregarded which permitted fraud and accounting errors to go undetected over a relatively long period of time. The following describes the control procedures disregarded and the effects of their absence on the accounting records.

- The County Treasurer does not have control procedures in place to safeguard and provide limited access to blank checks. Our inquiries and observation revealed a person who was not a county employee gained access to blank checks, stole blank checks, and was able to forge and cash the stolen checks. This individual was prosecuted and pled guilty to theft by unlawful taking. After this individual was released from incarceration he again gained access to blank checks belonging to the County, stole blank checks, and forged and cashed the stolen checks.
- The County Treasurer does not have control procedures in place to prevent others from posting to the appropriation ledger. Our inquiries and observation revealed the County Finance Officer posted forged checks to the appropriation ledger. These forged checks were posted to budgeted accounts as if the Fiscal Court had inspected supporting documentation and approved payment. We could find no evidence that the fiscal court approved the posting of these checks.
- The County Treasurer does not prepare bank reconciliations in a timely manner. This disregard for control procedures allowed forged checks to go undetected. Had the County Treasurer prepared bank reconciliations in a timely manner the forged checks would have been detected sooner.
- The County Treasurer did not use checks in consecutive order. Nor did she account for the sequence of checks. This caused confusion in the bank reconciliation process and helped to delay the discovery that blank checks had been stolen.

We recommend the County establish the following control procedures to help detect and prevent fraud and accounting errors from occurring.

- Blank checks should be placed in a secure area that is locked and access to blank checks should be limited to only the County Treasurer.
- The County Treasurer should use a stand-alone computer system. This computer should be password protected and all posting performed by the County Treasurer.

MAGOFFIN COUNTY
 SCHEDULE OF FINDINGS AND QUESTIONED COSTS
 For The Fiscal Year Ended June 30, 2003
 (Continued)

REPORTABLE CONDITIONS AND MATERIAL WEAKNESSES (Continued)

2003-04 Internal Controls Should be Implemented To Detect Fraud and Accounting Errors (Continued)

- Bank reconciliations should be prepared in a timely manner. Someone that does not have access to the accounting records should do the bank reconciliations.
- The County Treasurer should use checks in consecutive order and any departures should be accounted for and documented.

County Judge/Executive Bill W. May's Response:

- *Blank checks are secured in locked file cabinets located in the Treasurer's office. Files are open during times that Treasurer is working with checks.*
- *As funds do not allow for the purchase of new software and, as it is mandated that the County Judge/Executive maintain an appropriations ledger; the Finance Officer will institute a system of posting by hand, outside of the computer system; thus leaving the only access to the County Treasurer's records with the County Treasurer. Relating to posting of the forged checks: Fiscal Court approves claims prior to payment and not after the fact. In this situation, claims could not be approved prior to payment and it was imperative that they be recorded. This is why they were posted in the appropriations ledger and later backed out when the Salyersville National Bank reimbursed the county for withdrawals.*
- *See 1 above. Only someone with access to accounting records can properly do bank reconciliations.*
- *Agree that this is an unacceptable practice. Also agree that the previous practice of using these checks out of sequence contributed to delayed detection of the stolen checks mentioned several times in this report. Measures have been put in place to prevent this from being a problem in the future. Co-signers of checks are paying particular attention to assure that checks are used in sequence.*

2003-05 The County Treasurer Should Improve Internal Controls Over Blank Checks

The County Treasurer should improve controls over blank checks. In the audit report released for fiscal year 2002 the auditors reported a relative of an employee of the county stole blank checks, forged the necessary signatures, and cashed the checks receiving a total of \$28,571. In addition, the auditors reported an additional amount of \$27,597 was stolen in the fiscal year 2003 using the same method. During our procedures we confirmed the theft of \$27,597 and we discovered additional stolen checks that were cashed totaling \$1,761. This \$1,761 was not reported in the prior year audit report. The amount of checks stolen and cashed for fiscal year 2003 totaled \$29,358. The grand total of all stolen checks is \$57,929.

MAGOFFIN COUNTY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
For The Fiscal Year Ended June 30, 2003
(Continued)

REPORTABLE CONDITIONS AND MATERIAL WEAKNESSES (Continued)

2003-05 The County Treasurer Should Improve Internal Controls Over Blank Checks
(Continued)

The stolen checks began clearing the county's bank account on May 8, 2002. On July 9, 2002, then Deputy Judge Executive, Marcella Salyer, sent a letter to the Magoffin County Attorney's Office to report the stolen checks and request an investigation into this matter. The stolen checks stopped clearing the bank on August 5, 2002. On September 9, 2002, the individual suspected of stealing and forging the checks belonging to the county pled guilty to theft by unlawful taking. On October 24, 2002, checks that were determined to be stolen and forged again began clearing the county's bank accounts allegedly by the same individual that pled guilty to theft by unlawful taking. These checks continued to clear the county's bank account through November 15, 2002. Our observations and inquiries revealed that the County Treasurer has not taken any action to protect blank checks from being stolen. During our interviews with the current County Judge Executive, Bill W. May, we suggested that all checks be properly protected by placing them in a secure area with access limited to the County Treasurer only. On January 16, 2004, we observed blank checks that were not properly secured in the Treasurer's office. On January 20, 2004, the Finance Officer showed auditors that one of the file drawers where checks are stored was locked. However, auditors noted another file drawer that was not locked that also contained blank checks. We recommend the County Treasurer implement controls that will protect blank checks from theft.

County Judge/Executive Bill W. May's Response:

See response for #4 above.

2003-06 The County Treasurer Should Strengthen Controls Over Access To The Accounting
Records

During our observations and inquiries, we noted that controls over access to the accounting records are weak. The County has four computer terminals that are connected to a main server. From all four terminals it is possible to access the accounting system if the password is known. In addition, we determined the County Treasurer and the Finance Officer have the same password. Security levels should be established and only the County Treasurer should have access to the accounting program to post accounting transactions. We observed the Finance Officer was able to gain access to the accounting system through her terminal to post checks that were stolen and forged. These checks were not properly posted to an account that would indicate the fiscal court was aware that the check had been stolen and forged. We recommend computer controls be strengthened to prevent unauthorized access to the accounting system. Moreover, passwords should be changed on a regular basis and should not be shared among other employees.

County Judge/Executive Bill W. May's Response:

See response for #4 above.

MAGOFFIN COUNTY
 SCHEDULE OF FINDINGS AND QUESTIONED COSTS
 For The Fiscal Year Ended June 30, 2003
 (Continued)

REPORTABLE CONDITIONS AND MATERIAL WEAKNESSES (Continued)

2003-07 The County Treasurer Should Strengthen Controls Over Sequence Of Checks Used

During our testing of internal controls for expenditures, we noted large gaps in the sequence of checks posted to the County's check register for fiscal year 2003. The checks missing from the sequence of checks for 2003 were found in the sequence of checks posted during fiscal year 2002 and fiscal year 2004. Had checks been issued in sequence, it would have been easier to discover that blank checks had been stolen. We recommend the County Treasurer use checks in the proper sequence and properly maintain a file to account for all voided checks.

County Judge/Executive Bill W. May's Response:

See response for #4 above.

2003-08 The County Should Improve Their Internal Control Procedures

The Department for Local Government (DLG) requires the County Judge/Executive to keep certain records and make certain reports. These duties include:

- receiving all claims, and preparing a master claim list to present to the fiscal court
- preparing all checks, maintaining an appropriation ledger
- being responsible for the county's quarterly report
- reconciling the County Judge/Executive's appropriation ledger to the treasurer's appropriation ledger
- issuing purchase orders and maintaining a purchase order log
- maintaining time records (vacation/sick)

The Treasurer is currently completing these procedures. To strengthen controls and to be in compliance with DLG regulations, someone other than the Treasurer should complete the above duties. In order to properly segregate duties of the Treasurer, the following should occur:

- An independent person should list all receipts and agree them back to the treasurer's receipt ledger.
- An independent person should open bank statements and review them for unusual items, such as debit memos, and overdraft charges. This can be documented by the person initialing the envelope or bank statement.
- An independent person should complete bank reconciliations or review the treasurer's bank reconciliations for accuracy. This can be documented by the person initialing the bank reconciliation.
- An independent person should compare fiscal court order approvals to invoices and cancelled checks.

MAGOFFIN COUNTY
 SCHEDULE OF FINDINGS AND QUESTIONED COSTS
 For The Fiscal Year Ended June 30, 2003
 (Continued)

REPORTABLE CONDITIONS AND MATERIAL WEAKNESSES (Continued)

2003-08 The County Should Improve Their Internal Control Procedures (Continued)

County Judge/Executive Bill W. May's Response:

- *The Deputy Judge opens mail, reviews all claims which are then given to Financial Officer for assignment to correct appropriations accounts. This is not done by the Treasurer. The Treasurer then prepares a master list for Fiscal Court. Claims are reviewed by all three parties prior to presentation to Fiscal Court. In the future, the Judge/Executive staff will also assume the preparation of the master list.*
- *Judge/Executive staff maintains an appropriations ledger. Checks are printed from master list prepared by Treasurer. In the future, Judge/Executive will also assume printing of checks.*
- *Judge/Executive prepares county's quarterly appropriations report. This is not done by Treasurer.*
- *Judge/Executive reconciles all appropriations ledgers, trial balances, etc., with bank reconciliations.*
- *Purchase orders are issued by Judge/Executive's office staff. This is not done by Treasurer.*
- *Time records are calculated by payroll software. Payroll is currently prepared by Treasurer. The responsibility of preparing payroll will be assigned to Judge/Executive staff.*
- *Deputy Judge receives and records all receipts, which is then reviewed by Financial Officer who gives them to the Treasurer for receipt and deposit. Records are agreed back to bank statements.*
- *Deputy Judge receives a daily fax from bank with detailed activity for review. This person also opens bank statements upon receipt. In the future, she will be instructed to initial such.*
- *Bank reconciliations/review cannot be done by someone without access to accounting records.*
- *This is done by Judge/Executive secretary who mails out checks. Checks are compared with master list of claims and each check is documented upon mailing.*

2003-09 The County Should Require All Checks To Have Dual Signatures

During the engagement, auditors found several cancelled checks that did not have dual signatures. This indicates that either the Treasurer or the Judge's office did not review invoices and approve payment for them. Checks having dual signatures prevents errors and safeguards assets. We recommend the county make sure all checks have dual signatures and instruct the bank not to honor any checks without dual signatures.

County Judge/Executive Bill W. May's Response:

Dual signatures are required by both the Judge/Executive's office and the Treasurer's office, as well as the banking institution. However, during the year, four checks inadvertently were mailed with only one signature and also cleared the bank. This is not standard practice and every effort will be made to insure that this does not happen in the future.

MAGOFFIN COUNTY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
For The Fiscal Year Ended June 30, 2003
(Continued)

REPORTABLE CONDITIONS AND MATERIAL WEAKNESSES (Continued)

PRIOR YEAR FINDINGS FINANCIAL STATEMENTS AUDIT

- The County Should Establish Controls To Prevent Misuse And Theft Of County Assets
- The County Should Improve Accounting Practices
- The County Should Not Have Bank Overdraft Charges
- The County Lacks Proper Segregation Of Duties

C. FINDINGS AND QUESTIONED COSTS - MAJOR FEDERAL AWARDS PROGRAM
AUDIT

None.

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

MAGOFFIN COUNTY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

For The Fiscal Year Ended June 30, 2003

Federal Grantor Program Title <u>Grant Name (CFDA #)</u>	<u>Pass-Through Grantor's Number</u>	<u>Expenditures</u>
Cash Programs:		
U.S. Department of Housing and <u>Urban Development</u>		
Passed-Through State Department for Local Government:		
Community Development Block Grants - Sewer Project (CFDA #14.228)	Not Available	\$ 1,949,500
<u>U. S. Federal Emergency Management Agency</u>		
Passed-Through State Department of Military Affairs:		
Disaster and Emergency Assistance Grants - FEMA		
Disaster Recovery	FEMA-1407-DR-KY	36,278
Disaster Recovery (CFDA #83.544)	FEMA-1414-DR-KY	1,859
National Oceanic and <u>Atmospheric Administration</u>		
Passed-Through Eastern Kentucky PRIDE, Inc.:		
Pride Grant - 2002 Super Grant (Backbone Project) (CFDA #11.469)	Not Applicable	<u>69,320</u>
Total Cash Expenditures of Federal Awards		<u><u>\$ 2,056,957</u></u>

MAGOFFIN COUNTY
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

For The Fiscal Year Ended June 30, 2003

Note 1 - Basis of Presentation

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of Magoffin County, Kentucky and is presented on the modified cash basis of accounting. The information in the schedule is presented in accordance with the requirements of OMB Circular A-133, Audits of States, Local, Governments, and Non-Profit Organizations.

Note 2 - As required by this grant agreement, all program moneys received by the recipient after the completion of all recipient grant activities shall be used by the recipient for community or economic development activities eligible for assistance under Title I of the Housing and Community Development Act of 1974, so specified in the Commonwealth of Kentucky's Community Development Block Grant Eligible Activities Policy Statement.

CERTIFICATION OF COMPLIANCE -
LOCAL GOVERNMENT ECONOMIC ASSISTANCE PROGRAM

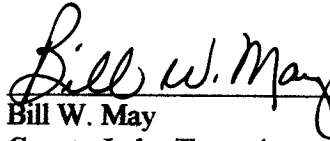
MAGOFFIN COUNTY FISCAL COURT

For The Fiscal Year Ended
June 30, 2003

CERTIFICATION OF COMPLIANCE
LOCAL GOVERNMENT ECONOMIC ASSISTANCE PROGRAM
MAGOFFIN COUNTY FISCAL COURT

For The Fiscal Year Ended June 30, 2003

The Magoffin County Fiscal Court hereby certifies that assistance received from the Local Government Economic Assistance Program was expended for the purpose intended as dictated by the applicable Kentucky Revised Statutes.



Bill W. May
County Judge/Executive



Mary Arnett
County Treasurer

